

After \$10 Open Market Purchase

Assets		Liabilities		
The Fed				
1	Treasury securities (+\$10)	\$93	\$36	Reserve accounts of banks (+\$10)
			\$57	Federal Reserve notes

Banks				
5	Reserve accounts (+\$10)	\$36	\$400	4
	Federal Reserve notes	\$4		
7	Loans (+\$90)	\$495	\$135	Net worth (to stockholders)

Bank Customers				
3	Checkable deposits (+\$100)	\$400	\$495	8
	Federal Reserve notes	\$53		
2	Treasury securities (- \$10)	\$42		
	Money supply = \$453 (\$400 + \$53)			

The following explanation explains what happens when the FED tries to increase the money supply. This example assumes you START with the chart that is on page 144 and make the following manipulations in order:

1. Here, the FED wishes to INCREASE the money supply. That means they have to be willing to BUY securities. They wish to ADD them (+10) to their assets.
2. Where do you get the securities? Bank customers, so their treasury securities DECREASE by \$10. What did the people get in return for their \$10 worth of securities, duh, \$10!!! Where did they put it? In their checkable deposits!
3. Why is this +\$100? Because when that first \$10 was put in the bank, what did it do? SEE Activity 4-3! It multiplied! The money creation process turned that \$10 Fed purchase into \$100 increase in the money supply! Whoo hoo!
4. If I add \$100 to checkable deposits, banks are liable for that \$100.
5. If banks are liable for \$100, 10% of that MUST be kept in reserve accounts.
6. If the bank reserve accounts increase by \$10, the FED now are liable for that \$10. Remember, banks send some or all of their required reserves to the Fed.
7. Since the banks have new deposits, they can lend more. How much more? \$90. Why 90? Because, \$10 is required reserves so \$90 is what's left.
8. The customers are liable for these loans to the bank. Now, try to do this in reverse on the problem that starts at the bottom of page 145 in your packet! You can do it!